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Harlequin Enterprises Limited Annual Report 1977

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Harlequin Enterprises Limited
Don Mills

JOHN T. BOON, C.B.E.
Chairman
Mills & Boon Limited
London

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Richardson Securities of Canada
Toronto

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Vice-Chairman
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Toronto

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Group Editorial Director, Fiction
Mills & Boon Limited
London

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Oxford University Press
London

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President, Harlequin Books
Don Mills

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General Counsel and Secretary

MARTIN A. REAUME
Controller

FREDERICK C. Z. SILK
Treasurer

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Chairman

PAUL J. SCHERER
English Language

L. R. JOHN RENDALL
Foreign Languages

BERNARD J. DENNIS-BROWNE
Finance and Administration

**The Overseas Committee has the function of advising the Board for companies operating outside North America*

CORPORATION INFORMATION

CORPORATE OFFICE
220 Duncan Mill Road
Don Mills, Ontario M3B 3J5
Telephone number (416) 445-5860

AUDITORS
Clarkson, Gordon & Co., Toronto

EXCHANGE LISTING
The Toronto Stock Exchange

REGISTRAR AND TRANSFER AGENT
Montreal Trust Company
Toronto, Halifax, Montreal,
Winnipeg, Calgary, Vancouver

ANNUAL MEETING
10.00 a.m., May 25, 1978
Jackson Room
Hotel Toronto
145 Richmond Street West
Toronto

HIGHLIGHTS

	% INCREASE	1977	1976
Revenues ($000)	54%	**$80,451**	$52,391
Net Earnings ($000)	135%	**$12,514**	$ 5,323
Fully Diluted Earnings per Share	136%	**$ .78**	$ .33
Equity per Share	57%	**$ 1.93**	$ 1.23
Romance Books Sold (000,000)	21%	**108.7**	89.7

HARLEQUIN is the world's leading publisher of romantic fiction, a special kind of literature that provides entertainment and relaxation for millions of women throughout the world. In 1977 more than 108 million books bearing the Company's imprints were purchased.

Harlequin is a rapidly growing international organization, with excellent opportunities for further development of its present markets, for diversification of its product line and for expansion into new markets. In addition to publishing romantic fiction, Harlequin publishes general and educational non-fiction through its British subsidiary, Mills & Boon Limited. In Canada, Harlequin distributes learning materials and books and publishes Canadian educational products through Scholar's Choice Limited.

Future developments will include continued growth in fiction publishing in North America and overseas, additional publishing enterprises in other languages, and diversification into related product areas.

LEFT TO RIGHT: W. Lawrence Heisey, President; Richard A. N. Bonnycastle, Chairman of the Board; William F. Willson, Vice-President, Finance.

REPORT TO SHAREHOLDERS

For the seventh consecutive year, Harlequin's sales and earnings achieved record levels. Consolidated revenues of $80,451,000 increased 54% over the prior year, while net earnings of $12,514,000 were up 135%. Fully diluted earnings per share increased to $.78 from $.33. These figures reflect a three-for-one common-stock split approved at a special shareholders' meeting held January 16, 1978.

This dramatic profit improvement was due to:

- unit sales growth in most markets, but particularly in the United States;
- entry into Germany and expansion of the publishing program in Holland;
- price increases in all major markets;
- more efficient operations and economies of scale in distribution and other overheads;
- foreign-exchange gains due to the depressed Canadian dollar.

In November 1977, the Board of Directors increased the semi-annual dividend from 4.33¢ to 4.5¢ per share. Total dividends in 1977 at 8.83¢ per share amounted to 11% of the year's earnings.

Product and language diversification continues to receive increasing attention. In 1977, Mills & Boon launched a new historical-romance series entitled *Masquerade* and completed testing of a romance series with medical settings. Harlequin Books tested two series during the year – a historical-romance series entitled *Harlequin Historicals* and a translation of a successful French romantic-suspense series to be entitled *Mystiques.* The newly acquired German operation launched a translation of the French detective series *SAS* under the imprint *Malko.* While Harlequin Holland introduced no new products, publication of the original series *Bouquet Reeks* was increased from four to six titles per month. Finally, Harlequin France was formed to publish French translations of Mills & Boon romances.

During 1978, new product launches will include *Harlequin Historicals* and *Mystiques* by Harlequin Books, *Doctor/Nurse* by Mills & Boon, a historical series by Harlequin Holland, and a romance series by Harlequin France.

Finally, the Company's continuing foreign-language development program will include a study of the Japanese market during 1978.

In order to evaluate the potential for media diversification, the Harlequin Film Division has been formed. The first feature film, *Leopard in the Snow,* was produced in 1977 and released in early 1978. Early results are encouraging and undoubtedly will lead to a larger-scale film operation.

Since 1970, total Company revenues have grown from \$7.7 million to \$80.5 million – a compound annual growth rate of 39.8%. During the same period, net earnings have grown from \$0.1 million to \$12.5 million.

Harlequin's corporate objective is to continue to protect and improve the return on our shareholders' investment by:

- further developing English-language markets for romantic fiction;
- developing and expanding publishing activities in other languages;
- diversifying the profit base by acquisition or internal development in areas that will capitalize on the Company's publishing, marketing or distribution skills and financial resources.

Important progress has already been made on these fronts in recent years, and the continued development of a dynamic international organization holds exciting prospects for the future.

Since 1975 when the Canadian Authors Association reinstated its Literary Awards program, Harlequin has assisted the CAA by funding the cost of mementos and cash awards. The program consists of silver medals and cash awards of \$1,000 for each of four categories – fiction, nonfiction, drama and poetry.

No drama award was made for 1977. In the fiction category, the winner was Carol Shields of Ottawa for her novel *Small Ceremonies,* published by McGraw-Hill Ryerson. The nonfiction winner was Bruce Hutchison for reflections on his lifetime, *The Far Side of the Street,* published by Macmillan of Canada. The poetry winner was Capt. J. S. Stephen of C.F.B. Shilo, Manitoba, for his book *Beothuck Poems,* published by Oberon Press.

Harlequin's success is due to the energy and dedication of our employees and associates around the world. We are grateful for their contribution and for their enthusiastic response to the challenges of the Company's growth.

On behalf of the Board

RICHARD A. N. BONNYCASTLE

W. LAWRENCE HEISEY

NET REVENUES (\$000)

1970	\$ 7,719
1971	\$ 7,978
1972	\$15,277
1973	\$20,358
1974	\$30,983
1975	\$43,249
1976	\$52,391
1977	\$80,451

NET EARNINGS (\$000)

1970	\$ 110
1971	\$ 454
1972	\$ 1,577
1973	\$ 2,737
1974	\$ 3,527
1975	\$ 4,418
1976	\$ 5,323
1977	\$12,514

FULLY DILUTED EARNINGS PER SHARE

1970	\$ .01
1971	\$ .03
1972	\$ .10
1973	\$ .17
1974	\$ .23
1975	\$ .28
1976	\$ .33
1977	\$ .78

EQUITY PER SHARE

1970	\$ .31
1971	\$ .34
1972	\$ .46
1973	\$ .61
1974	\$ .79
1975	\$ .97
1976	\$ 1.23
1977	\$ 1.93

DIVIDENDS DECLARED (\$000)

1972	\$ 114
1973	\$ 414
1974	\$ 991
1975	\$ 1,227
1976	\$ 1,316
1977	\$ 1,397

ROMANCE BOOKS SOLD BY HARLEQUIN COMPANIES

Millions of Books – Net

1965	6
1966	8
1967	12
1968	13
1969	17
1970	19
1971	25
1972	29
1973	42
1974	63
1975	72
1976	90
1977	109

HARLEQUIN BOOKS

LEFT TO RIGHT: Samuel A. Whitfield, Vice-President, Consumer Sales; Richard H. Bellringer, President; Louis Krupat, Vice-President, Finance and Administration.

Harlequin Books, the Company's North American publishing arm, continued to move ahead at a rapid rate with another record year, contributing substantially to the increased revenue and profitability of the Company.

The division currently publishes under two main imprints, *Harlequin Romances* (consisting of eight new titles per month) and *Harlequin Presents* (consisting of four new titles per month). In addition, *Romance Treasury,* a hard-cover romance series is sold exclusively through the division's mail order operation.

Growth in sales of these products will be complemented in 1978 and beyond by the introduction of new publishing products. *Harlequin Historicals,* successfully tested in 1977, were launched at retail in January, 1978. *Mystiques,* translations of a successful French romantic-suspense series, are in test markets and will probably be launched in the United States and Canada later in 1978. The division maintains a continuing program of product research and will continue to introduce new products as they are developed.

In the United States, Harlequin Books sales

representation is handled by Pocket Books Distribution Corp., a division of Simon & Schuster. In Canada, sales representation is handled by the division's newly formed Canadian sales organization. The effort of the two sales organizations is augmented by Harlequin Reader Service, which plays an important role in providing a service to consumers who are not directly served through regular trade channels.

Several important steps were taken in 1977 to ensure continued good service to our growing list of customers:

- The Harlequin Distribution Center in Buffalo, N.Y., opened in 1976, was increased in size by 40%. It now serves the bulk of United States' distribution needs.
- A 40,000-square-foot distribution center was opened in Stratford, Ontario to serve our Canadian customers.
- The Book Division's United States sales supervision group was relocated from New York City to new, expanded offices in Hackensack, New Jersey.
- Personnel were added in management and operational positions to meet expanded requirements.

As a major step in the division's long-range diversification program, in mid-1977 the Company acquired Ideals Publishing Corporation of Milwaukee, Wisconsin, which has become part of the Book Division. Ideals Publishing Corporation, well-known for inspirational magazines and related hard- and soft-cover books, also provides well-established lines of cookbooks and greeting cards. The Company anticipates that Ideals Publishing will make a substantial contribution to the division's long-term growth.

Finally, a new entity, Jonathan-James Books, has been formed to enter the field of international book packaging. This arm of the division will manage the creative and publishing process for new books on a worldwide, pre-sold basis on behalf of other publishers. The first book published in 1977 was *Kain and Augustyn.*

The Harlequin Overseas Group consists of the Mills & Boon operations in Great Britain and Australia, and the Harlequin companies publishing in languages other than English. In Europe, the Group now encompasses operations in Holland, West Germany and France and has a continuing research program into publishing in other languages.

ENGLISH LANGUAGE

LEFT TO RIGHT: Alan W. Boon, Group Editorial Director, Fiction; John T. Boon, C.B.E., Chairman; Paul Scherer, Managing Director.

Mills & Boon Limited

Mills & Boon Limited, London, is the basic editorial source of the company's romantic-fiction series, publishing 15 titles per month in hard-cover. These titles and the company's backlist form the basis of Mills & Boon paperback series published in the United Kingdom and exported to Harlequin operations in Australia and New Zealand, and to independent distributors in many other countries. In addition, this hard-cover publishing is the source of Harlequin series published in Canada and the United States and translated into German, French and Dutch for publication in West Germany, France and the Netherlands. Mills & Boon also publishes general and educational books on a wide range of subjects.

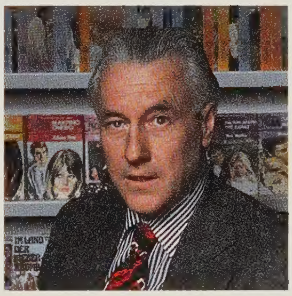
Editorial development continues to be a focus of attention in Mills & Boon. The division's paperback line of ten *Romances* each month was enhanced in 1976 with the introduction of the *Classics* series of four back-list titles a month. A new venture in 1977 was the launch of a series of historical-romances under the imprint of *Masquerade*. In addition, the testing of the *Doctor/Nurse* romance series was completed in 1977 and a program of two titles per month will be started in 1978. As in North America, product diversification continues to be of major importance to the division.

During 1977 a detailed research study was conducted into the reading and buying habits of actual and potential customers. This will form the basis in 1978 for an extensive paperback consumer advertising and promotion campaign. The aim of this campaign will be to further increase market penetration.

In the non-fiction area, an experiment was made in the publishing of international co-editions. Titles produced in 1977 included *Embroidery of all Russia*, *Anatomy of Costume*, and *International Dolls House Book*.

A later development during 1977 was the formation of Marshall Editions, a company that will specialize in co-edition publishing and international book packaging. Mills & Boon holds a 75% interest in this company.

FOREIGN LANGUAGES



L. R. John Rendall

Harlequin Holland

Since its inception in 1974, Harlequin Holland has become a market leader for romantic-fiction paperbacks because of product quality and editorial standards, consumer advertising and point-of-sale programs.

The division successfully launched its first series, *Bouquet Reeks*, in April 1975 at four titles per month. This was followed in September 1976 by *Jasmijn*, a fortnightly romance series in a less-expensive format. In May 1977, due to excellent market response, publication of *Bouquet Reeks* was successfully increased to six titles per month.

During 1978 publication of *Jasmijn* will be increased to two titles fortnightly, and a new historical series based on Mills & Boon titles will be launched.

Harlequin Enterprises GmbH

In April 1976, Cora Verlag KG was established in West Berlin. Harlequin holds a 50% interest, the balance being held by Koralle Verlag AG, a subsidiary of Axel Springer Verlag AG of West Germany. Koralle had published Mills & Boon romances in the German language for several years and has been a market leader in design, promotion and editorial quality.

The two romance series, *Julia* and *Romana*, were complemented in April 1976 by the introduction of *Bianca*, a romance series with medical settings. All three series are published fortnightly – two titles in the cases of *Julia* and *Romana* and one title in the case of *Bianca*. In 1978 publication of *Bianca* will be increased to two titles fortnightly.

In April 1977 the original French detective series *SAS* by Gerard de Villiers was launched on a bimonthly basis in translated form under the imprint *Malko*. The launch was supported by a major advertising program and represents the first major sale of paperback books through the magazine distribution circuit in Germany. Publication will be increased to a monthly basis in 1978.

Harlequin France

Harlequin France was established in 1977 to publish French translations of Mills & Boon romances.

The launch of the first romantic-fiction series is scheduled for 1978, with shipments at four titles per month. The launch will be supported by a major consumer advertising promotion program aimed at rapid market penetration.

Products under investigation for future introduction include a historical series.

SCHOLAR'S CHOICE LIMITED

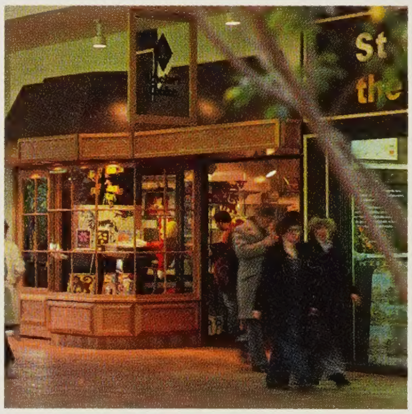
R. Alexander de Boer,
President

Scholar's Choice is a major supplier of learning and resource materials to the Canadian education market. The company is a national distributor, supplying more than 25,000 items, including learning materials, supplies and equipment, film strips and library books to schools and teachers in every province.

Based in Stratford, Ontario, the company markets its products through a catalogue program complemented by sales personnel located throughout Canada.

A Personal Shopping Centre has been established in Vancouver, where teachers and librarians can select and purchase materials in person.

In addition, a retail store was opened in Toronto in 1977 to bring educational products closer to teachers, parents and students.

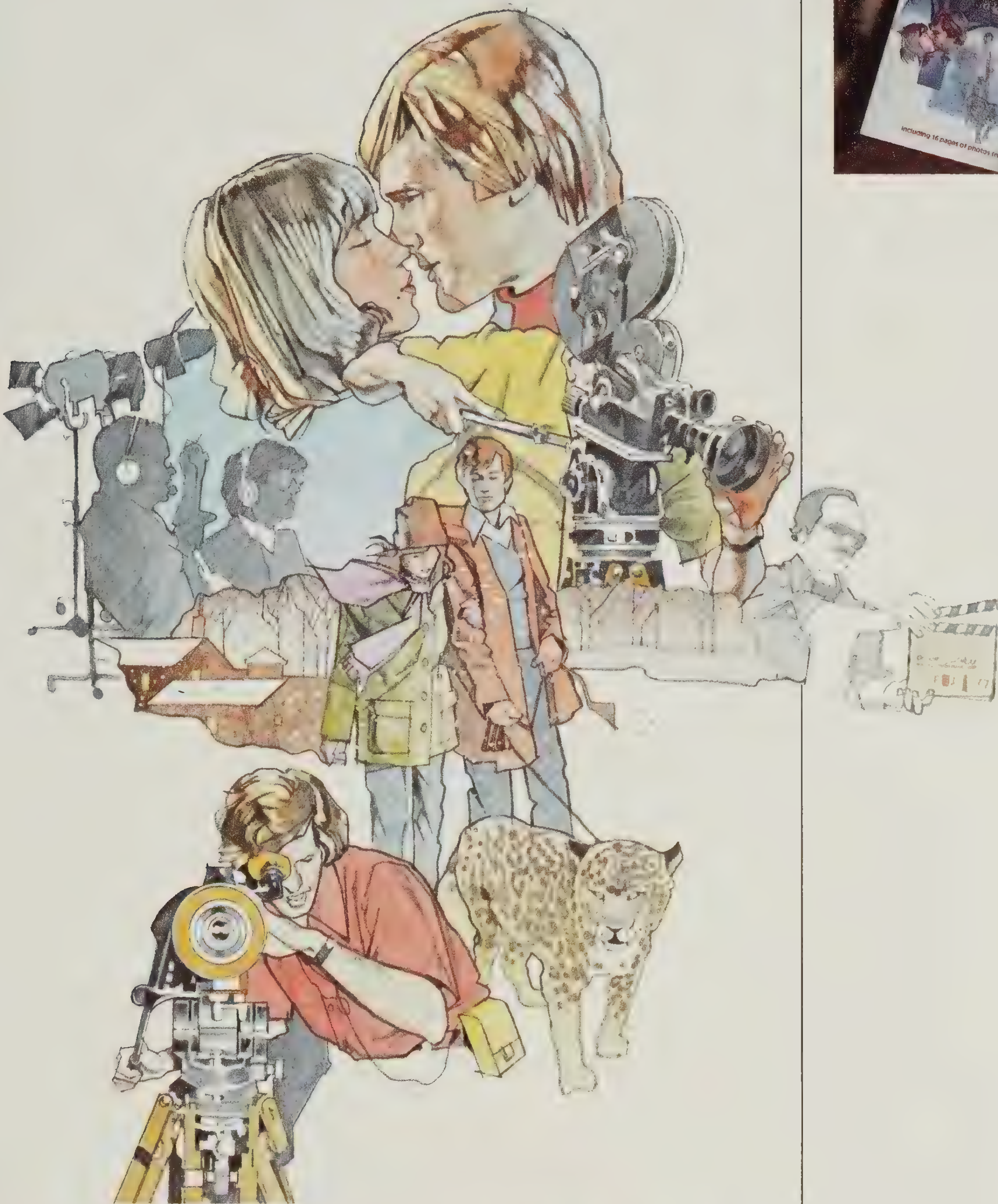


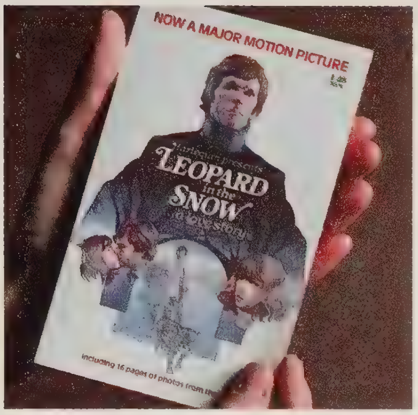
Scholar's Choice continues to develop its publishing program with emphasis on inexpensive educational materials in major subject areas. While primary emphasis remains on Canadian-oriented products, the company has also begun to develop or modify education programs for sale in the United States market.

Experienced classroom teachers are authors or editors for each new product, ensuring that all materials are relevant to today's learning requirements. More than 50 authors and editors throughout Canada are under contract to Scholar's Choice at present.

During 1977, several new or revised products were published. A major revision and metrication of the *Check and Double Check* math-workbook program has been successfully completed.

HARLEQUIN FILMS





The Company's major resource is its expertise in the publishing of romantic fiction. The Film Division has been formed to test whether this resource can be profitably exploited in theatrical or television films.

The first feature film, *Leopard in the Snow,* was based on the Mills & Boon/Harlequin novel of the same name by Anne Mather. The movie was produced under the Anglo-Canadian Film Treaty, starring Keir Dullea, Susan Penhaligon, Kenneth More, Jeremy Kemp, and Billie Whitelaw. Filming took place in England and Canada during the first six months of 1977.

During 1977, distribution agreements were signed for the United States, Canada, the United Kingdom, South Africa, Australia and New Zealand, Japan, Israel, the Middle East and the West Indies, with others under negotiation.

The film was released early in 1978 in Canada, the United States, Ireland and Japan, with immediate results being very encouraging. Release is scheduled in other countries throughout 1978. Release of the film has been tied in with a reissue of the book.

The division is currently looking at the possibility of producing a second feature film in the summer of 1978. The film would be shot in Europe and North America, with an international cast and crew. Release is anticipated for early 1979.

The division is also considering other film and television projects relating to the company's over-all substantial literary backlist.

Harlequin Enterprises Limited
(Incorporated under the laws of Canada)

CONSOLIDATED BALANCE SHEET (thousands of dollars)

December 31, 1977 *(with comparative figures at December 31, 1976)*

ASSETS	**1977**	1976
CURRENT ASSETS:		
Cash	**$ 511**	$ 508
Short-term investments, at cost (which approximates market)	**24,596**	8,779
Accounts receivable *(note 4)*	**8,522**	5,513
Inventories, at the lower of cost and net realizable value	**8,376**	5,554
Prepaid expenses and other current assets *(note 5)*	**5,957**	3,251
Total current assets	**47,962**	23,605
FIXED ASSETS, at cost *(note 6)*	**2,792**	1,837
Less accumulated depreciation	**1,076**	820
Total fixed assets	**1,716**	1,017
GOODWILL *(note 2)*	**6,367**	5,750
	$ 56,045	$ 30,372

On behalf of the Board:

Director

Director

(See accompanying notes to consolidated financial statements)

LIABILITIES AND SHAREHOLDERS' EQUITY

	1977	1976
CURRENT LIABILITIES:		
Bank indebtedness	**$ 1,107**	$ 368
Accounts payable and accrued charges	**11,153**	7,394
Income taxes payable	**10,370**	2,040
Dividends payable	**712**	684
Total current liabilities	**23,342**	10,486
Long-term liabilities *(note 7)*	**2,171**	527
SHAREHOLDERS' EQUITY:		
Capital stock *(notes 1 and 8)*		
Authorized: 27,000,000 common shares without nominal or par value		
Issued: 15,825,624 shares (1976 – 15,792,624 shares)	**4,217**	4,161
Retained earnings	**26,315**	15,198
	30,532	19,359
	$ 56,045	$ 30,372

AUDITORS' REPORT

To the Shareholders of
Harlequin Enterprises Limited:

We have examined the consolidated balance sheet of Harlequin Enterprises Limited as at December 31, 1977 and the consolidated statements of earnings and retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion these consolidated financial statements present fairly the financial position of the company as at December 31, 1977 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied in all material respects [see note 2(d)] on a basis consistent with that of the preceding year.

Toronto, Canada
February 24, 1978

Clarkson, Gordon & Co.
Chartered Accountants

CONSOLIDATED STATEMENT OF EARNINGS & RETAINED EARNINGS (thousands of dollars)

for the year ended December 31, 1977 *(with comparative figures for 1976)*

EARNINGS

EARNINGS	**1977**	1976
GROSS INCOME	**$ 80,451**	$ 52,391
EARNINGS FROM OPERATIONS BEFORE THE FOLLOWING:	**$ 24,211**	$ 10,119
Deduct (Add):		
Exchange adjustment *(note 2)*	**(415)**	295
Depreciation	**245**	203
Interest and other income	**(871)**	(460)
Other *(note 10)*	**181**	39
EARNINGS BEFORE INCOME TAXES	**25,071**	10,042
Income taxes	**12,557**	4,719
NET EARNINGS FOR THE YEAR	**$ 12,514**	$ 5,323
EARNINGS PER SHARE *(notes 1 and 9):*		
Basic	**$ .79**	$ .34
Fully diluted	**$ .78**	$ .33

RETAINED EARNINGS

RETAINED EARNINGS, BEGINNING OF YEAR	**$ 15,198**	$ 11,191
NET EARNINGS FOR THE YEAR	**12,514**	5,323
	27,712	16,514
DIVIDENDS DECLARED PER SHARE *(note 1)* (1977–$0.088, 1976–$0.08)	**1,397**	1,316
RETAINED EARNINGS, END OF YEAR	**$ 26,315**	$ 15,198

(See accompanying notes to consolidated financial statements)

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION (thousands of dollars)

for the year ended December 31, 1977 *(with comparative figures for 1976)*

	1977	1976
SOURCE OF FUNDS:		
Net earnings for the year	**$ 12,514**	$ 5,323
Add –		
Depreciation	**245**	203
Amortization of goodwill	**64**	39
Funds from operations	**12,823**	5,565
Increase in German long-term liabilities	**694**	
Common shares issued	**56**	
Total funds provided	**13,573**	5,565
APPLICATION OF FUNDS:		
Cost of acquisition *(excluding net current assets) (note 3)*	**976**	2,085
Less portion of purchase price represented by a deferred liability	**950**	527
	26	1,558
Dividends	**1,397**	1,316
Fixed assets *(net)*	**649**	367
Total funds applied	**2,072**	3,241
INCREASE IN WORKING CAPITAL	**11,501**	2,324
WORKING CAPITAL, BEGINNING OF YEAR	**13,119**	10,795
WORKING CAPITAL, END OF YEAR	**$ 24,620**	$ 13,119
CHANGES IN COMPONENTS OF WORKING CAPITAL:		
Increase (decrease) in current assets –		
Cash and short-term investments, net of bank indebtedness	**$ 15,081**	$ 5,713
Accounts receivable	**3,009**	(776)
Inventories	**2,822**	(1,078)
Prepaid expenses and other current assets	**2,706**	1,208
	23,618	5,067
Increase (decrease) in current liabilities –		
Accounts payable and accrued charges	**3,759**	3,336
Dividends payable	**28**	52
Income taxes payable	**8,330**	(645)
	12,117	2,743
INCREASE IN WORKING CAPITAL	**$ 11,501**	$ 2,324

(See accompanying notes to consolidated financial statements)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 1977

1. Change in share capital

In accordance with Supplementary Letters Patent dated January 23, 1978, the company's authorized and issued capital was subdivided on a three-for-one basis. The accompanying financial statements reflect these changes in authorized and issued share capital and all references to shares issued during the year, earnings per share and dividends per share reflect this subdivision.

2. Summary of significant accounting policies

(a) BASIS OF CONSOLIDATION – The accompanying consolidated financial statements consolidate the accounts of Harlequin Enterprises Limited and its subsidiaries, all of which are wholly owned. In addition, the Company includes its pro rata share of the assets, liabilities, income and expenses of an investment in a joint venture. Its principal subsidiaries are:

Mills & Boon Limited – Britain
Mills & Boon Pty. Limited – Australia
Harlequin Enterprise S.A. – Switzerland
Harlequin Enterprises B.V. – Netherlands
Harlequin Enterprises GmbH – West Germany
Scholar's Choice Limited – Canada
Harlequin Books Incorporated – U.S.A.
Ideals Publishing Corporation – U.S.A.

All acquisitions have been accounted for using the purchase method of accounting with the Company's share of earnings being included from dates of acquisition.

(b) EXCHANGE TRANSLATION – The financial statements of the foreign subsidiaries have been translated to Canadian dollars as follows: current assets and liabilities at exchange rates prevailing at December 31; fixed assets, goodwill and other assets, depreciation and long-term liabilities at exchange rates prevailing at dates acquired or assumed; income and expenses (excluding depreciation) at average rates during the period. The exchange adjustments resulting from such translation practices are reflected in consolidated earnings.

(c) GOODWILL – Goodwill represents the excess of the purchase price of investments in subsidiaries and a joint venture over the Company's interest in the fair value of the net assets acquired. Of the total of $6,367,000 on the balance sheet, $3,704,000 represents goodwill with respect to investments acquired before December 31, 1973 and for which the Company has made no provision for amortization since in the opinion of management there has been no reduction in value. The balance, $2,663,000, representing goodwill with respect to investments made during 1976 and 1977, is being amortized over forty years as required under generally accepted accounting principles adopted in Canada subsequent to 1973.

(d) RECOGNITION OF INCOME – During the year one of the Company's divisions changed its method of income recognition from one based on date of "release of title" to one based on date of shipment, which is the basic method followed by other divisions. The Company believes that the method now employed more appropriately measures the actual earnings of this division. The effect of the change was to increase net earnings in 1977 by $480,000 (3 cents per share) including $265,000 (1.7 cents per share) applicable to prior periods.

(e) PROVISION FOR BOOK RETURNS – For accounting purposes, the Company follows the practice of making a provision for book returns determined by reference to past experience. For tax purposes, the Company is not permitted to deduct the provision until the year that the books are actually returned; the amount of tax thus prepaid is carried on the balance sheet under "prepaid expenses and other current assets" (note 5).

(f) WITHHOLDING TAX – Provision is made for all taxes which it is estimated will be payable on future remittances of earnings from operations outside Canada. At present the total on which tax has been provided includes all undistributed earnings of these subsidiaries since the Company does not consider these to have been reinvested on a long-term basis.

(g) FILM – During 1977 the Company produced a feature-length film which had not been released by the year-end. The cost of the film has been capitalized in the accounts net of the proceeds from the sale of distribution rights. The Company plans to amortize this cost over a period not to exceed two years (note 5).

3. Acquisition

Effective July 7, 1977, the Company acquired the business of Ideals Publishing Corporation in the United States for $1,491,000 payable as follows:

Cash	$ 541,000
Assumption of long-term liability (U.S. $898,000) (note 7)	950,000
	$1,491,000

The acquisition equation of this investment which has been accounted for as a purchase may be summarized as follows:

Working capital	$ 515,000
Fixed assets	295,000
	810,000
Excess of cost of investment over interest in estimated fair value of net assets (Goodwill)	681,000
	$1,491,000

4. Accounts receivable

The major items in accounts receivable at December 31 are as follows:

	1977	1976
Due from customers	$14,982,000	$9,573,000
Other receivables	589,000	312,000
	15,571,000	9,885,000
Less provision for returns	7,049,000	4,372,000
Net receivable	$ 8,522,000	$5,513,000

5. Prepaid expenses and other current assets

Prepaid expenses and other current assets include prepaid income taxes of $3,368,000 ($2,062,000 in 1976) relating to provisions made for accounting purposes that have not yet become deductible for tax purposes and the cost of the feature-length film, net of proceeds from sale of distribution rights, of $950,000.

6. Fixed assets

The major categories of fixed assets at December 31, 1977 are as follows:

	Cost	Accumulated depreciation	Rates
Buildings	$ 306,000	$ 47,000	5%
Furniture, machinery & equipment	1,677,000	730,000	15-20%
Vehicles	288,000	74,000	25-30%
Leasehold improvements	436,000	225,000	
	2,707,000	1,076,000	
Land	85,000		
	$2,792,000	$1,076,000	

Straight-line depreciation is written on leasehold improvements over the terms of the leases, and the diminishing balance method is applied to the other depreciable assets at the rates shown above.

7. Long-term liabilities

Long-term liabilities consist of:

Note payable (U.S. $898,000) due in 9 equal instalments plus interest which is not to exceed 10% or be less than 6% from 1979-1987	$ 950,000
Loan payable at 3½% over German bank rate:	
due May 2, 1979 (DM 1,000,000)	427,000
due May 2, 1980 (DM 1,000,000)	427,000
due May 4, 1981 (DM 860,000)	367,000
	$2,171,000

8. Capital stock

During the year ending December 31, 1977, 33,000 of the Company's authorized common shares were issued under the employee share option plan for an aggregate value of $56,000.

At December 31, 1977 there were options outstanding to employees which expire between 1983 and 1987 covering 176,700 shares (including 33,300 to officers) at prices ranging from $1.20 to $8.76 per share.

9. Earnings per share

Basic earnings per share have been computed on the basis of the weighted average number of shares outstanding during each year.

Fully diluted earnings per share reflect the effect on earnings per share which would have resulted if all of the shares issued during the year, as well as the shares subject to employee stock options, had been issued at the beginning of the year, the funds derived therefrom being assumed to produce an annual return of 8% (9% in 1976) before applicable income taxes.

10. Other expenses

Amortization of goodwill	$ 64,000
Interest on long-term liabilities	117,000
	$181,000

11. Lease commitments

The Company is committed to annual rentals of approximately $911,000 for each of the next five years.

12. Remuneration of directors and officers

The aggregate remuneration ($8,300 of which was to the directors, as such) charged to consolidated earnings for the year ended December 31, 1977 in respect of twelve directors (three of whom were also officers), and five other officers of the Company, was as follows:

By Harlequin Enterprises Limited	$1,236,917
By Mills & Boon Limited	121,276
	$1,358,193

13. Anti-inflation program

Under the federal government's Anti-Inflation Program, the Company is subject until December 31, 1978 to mandatory compliance with legislation that controls prices and profit margins. Management is of the opinion that the Company is in compliance with the requirements of the anti-inflation legislation. Dividends to the Company's common shareholders during the year ending October 13, 1978 may not exceed, without prior approval, $.092 per share.

HARLEQUIN ENTERPRISES LIMITED

CORPORATE OFFICE

W. Lawrence Heisey
PRESIDENT

Norman A. Crawford
GENERAL COUNSEL AND SECRETARY

Frederick C. Z. Silk
TREASURER

William F. Willson
VICE-PRESIDENT, FINANCE

Martin A. Reaume
CONTROLLER

DIVISIONAL MANAGEMENT

HARLEQUIN BOOKS

Richard H. Bellringer
PRESIDENT

Samuel A. Whitfield
VICE-PRESIDENT, CONSUMER SALES

Louis Krupat
VICE-PRESIDENT,
FINANCE & ADMINISTRATION

Jerry Goldman
DIRECTOR, DISTRIBUTION

Fred Kerner
DIRECTOR, PUBLISHING

John D. Prestage
DIRECTOR, RETAIL SALES

David R. Sanderson
DIRECTOR, MARKETING

Roberta S. Steinberg
DIRECTOR, PERSONNEL

Philip G. Whalen
DIRECTOR, FINANCE

MILLS & BOON (London)

John T. Boon, C.B.E.
CHAIRMAN

Alan W. Boon
GROUP EDITORIAL DIRECTOR, FICTION

Paul J. Scherer
MANAGING DIRECTOR

Bernard C. J. Rogers
FINANCIAL DIRECTOR AND
COMPANY SECRETARY

Heather Jeeves
EDITORIAL DIRECTOR, FICTION

Arthur T. McKay
DIRECTOR, PUBLISHING

Owen E. Bryant
U.K. MARKETING DIRECTOR

Michael N. Saraceno
PRODUCTION DIRECTOR

SCHOLAR'S CHOICE

R. Alexander de Boer
PRESIDENT

Bruce T. Wills
VICE-PRESIDENT, FINANCE

HARLEQUIN HOLLAND

Klaas Koome
MANAGING DIRECTOR

CORA VERLAG (Germany)
(50% owned)

Klaas Koome
JOINT MANAGING DIRECTOR

Hans Sommer
JOINT MANAGING DIRECTOR

HARLEQUIN FRANCE

Christian Chalmin
MANAGING DIRECTOR

IDEALS PUBLISHING

William T. Webster
ACTING PRESIDENT

J. Kenneth McEachran
VICE-PRESIDENT,
FINANCE & ADMINISTRATION

MILLS & BOON (Australia)

Les A. Ward
MANAGING DIRECTOR

HARLEQUIN LONDON

Robert W. Jones
FINANCIAL CONTROLLER

EIGHT-YEAR OPERATING HISTORY

	1977	1976	1975	1974	1973	1972	1971	1970
OPERATING RESULTS ($000)								
Net revenues	**$80,451**	$52,391	$43,249	$30,983	$20,358	$15,277	$ 7,978	$ 7,719
Net earnings	**12,514**	5,323	4,418	3,527	2,737	1,577	454	110
FINANCIAL POSITION ($000)								
Current assets	**$47,962**	$23,605	$19,172	$14,288	$ 9,941	$ 6,132	$ 6,151	$ 3,631
Current liabilities	**23,342**	10,486	8,377	7,043	5,061	3,396	3,679	2,098
Working capital	**24,620**	13,119	10,795	7,245	4,880	2,736	2,472	1,533
Net fixed assets	**1,716**	1,017	853	716	507	201	211	229
Other assets	**6,367**	5,750	3,704	3,704	3,741	3,867	3,933	2,152
Other liabilities	**2,171**	527	–	–	–	–	2,275	27
Shareholders' equity	**30,532**	19,359	15,352	11,665	9,128	6,804	4,341	3,887
FINANCIAL RATIOS								
Net earnings on net revenues	**15.6%**	10.2%	10.2%	11.4%	13.4%	10.3%	5.7%	1.4%
Net earnings on equity	**41.0%**	27.5%	28.8%	30.2%	30.0%	23.2%	10.5%	2.8%
Working capital ratio	**2.1:1**	2.3:1	2.3:1	2.0:1	2.0:1	1.8:1	1.7:1	1.7:1
Fully diluted earnings per share	**$ .78**	$ .33	$ .28	$ .23	$ .17	$ .10	$ .03	$ .01
Equity per share	**$1.93**	$1.23	$ .97	$ .79	$ .61	$ .46	$ .34	$ .31
Dividends per share	**$ .09**	$ .08	$ .08	$ .07	$ .03	$ .01	–	–
OTHER DATA								
Shares outstanding (000)	**15,826**	15,793	15,793	14,859	14,859	14,859	12,609	12,609
Number of employees	**881**	584	332	313	240	201	157	188

HARLEQUIN ENTERPRISES LIMITED